

Perspectives on Venture Capital and Fixed Income Markets

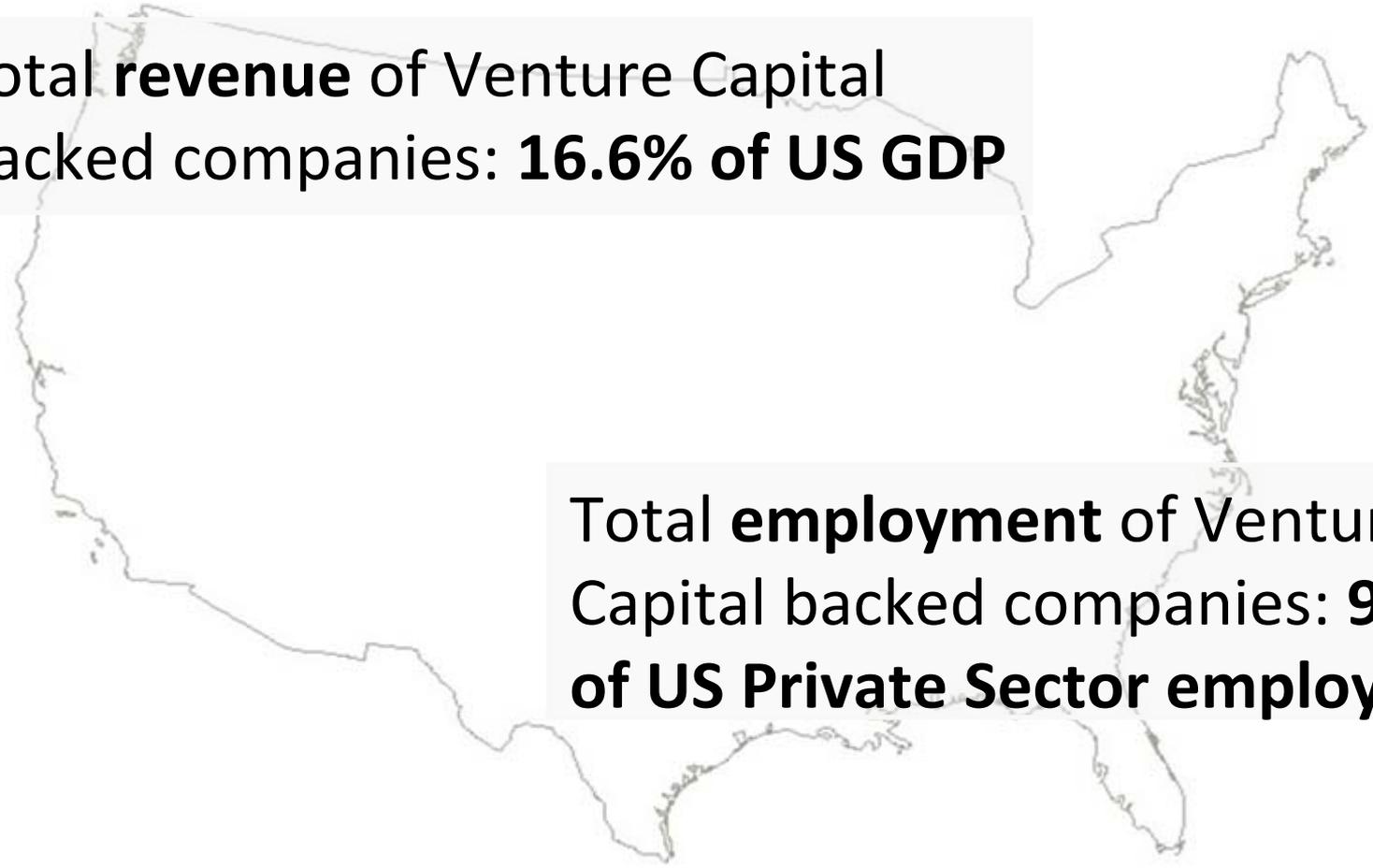
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Today's Discussion: Three Significant Forces for National Economic Growth

- **Venture Capital**
- Fixed Income Markets
- Role of Diaspora

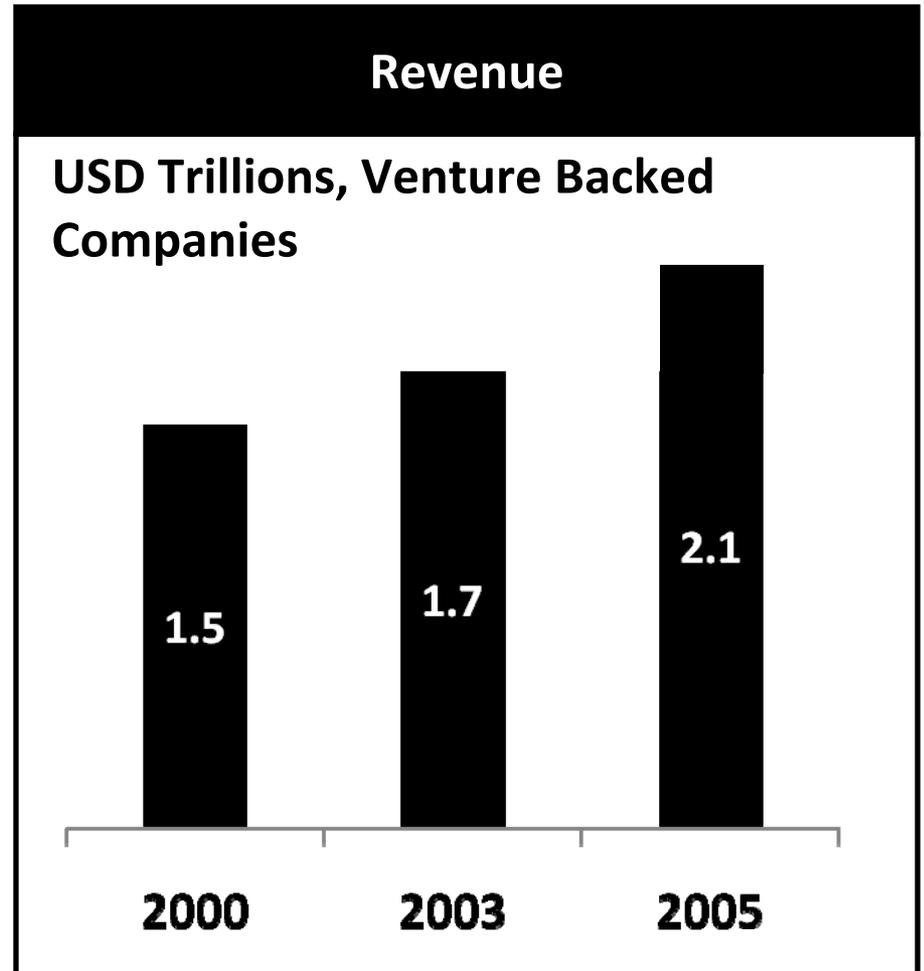
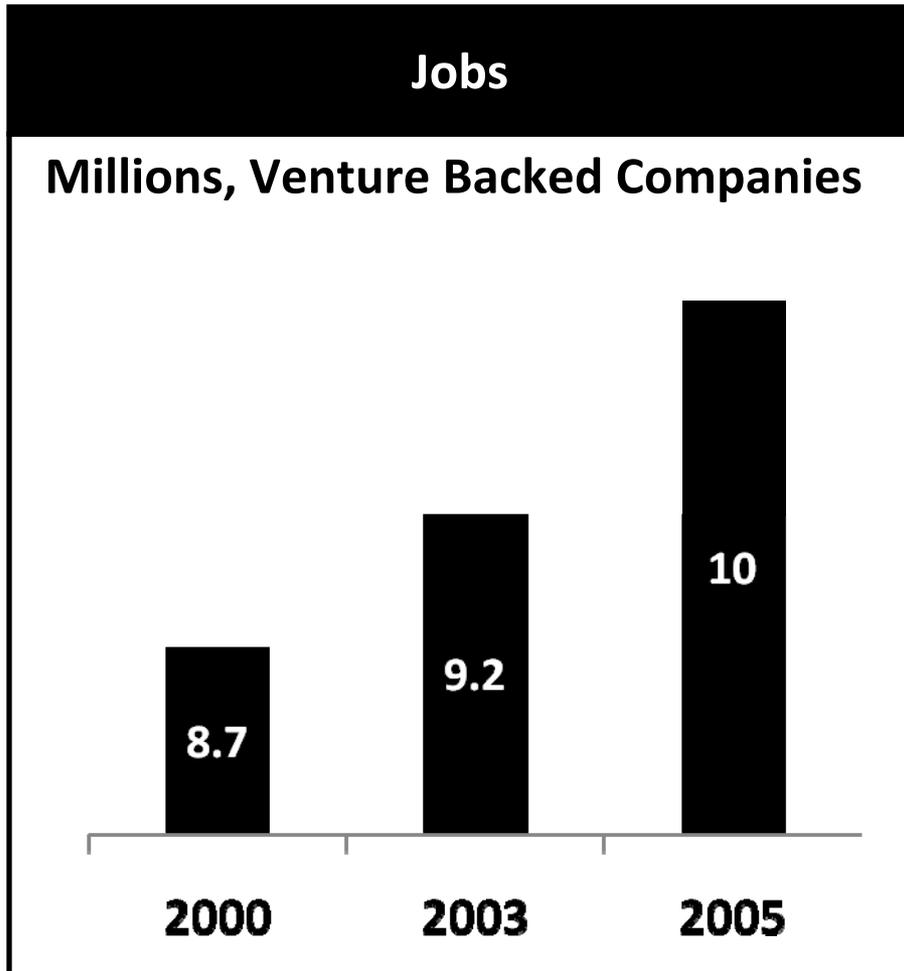
Venture Capital Is a Major Force in the US Economy



Total **revenue** of Venture Capital backed companies: **16.6% of US GDP**

Total **employment** of Venture Capital backed companies: **9.0% of US Private Sector employment**

Venture Capital Drives US Economic Growth By Creating Jobs and Revenue



Total US VC investment in 2005 = \$23 billion (0.2% of US GDP)

Venture Capital Backed Companies Have Outperformed Their Non-Venture Counterparts

Recent Past: Employment and Revenue growth, CAGR 2003-2005

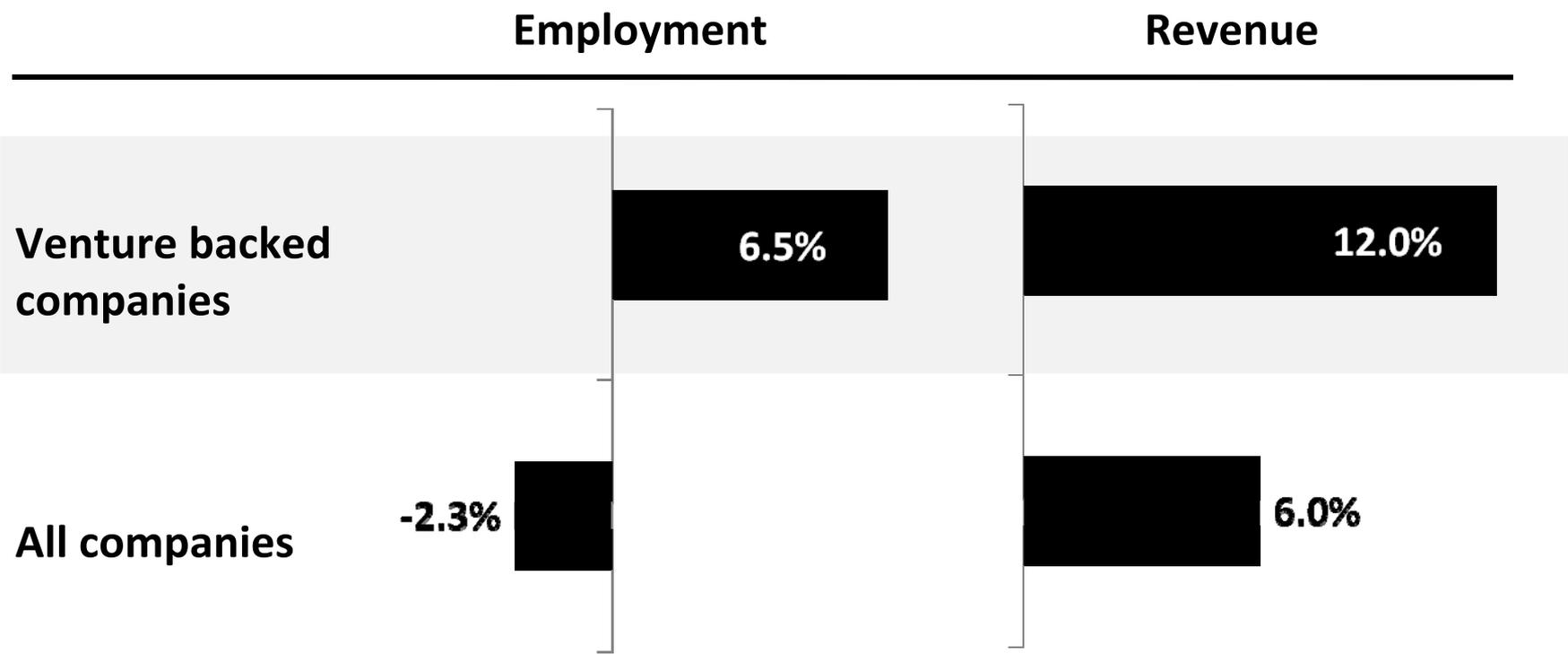


Note: 2003-2005 GDP growth (nominal) was 13.5% (i.e., 6.5% CAGR)

Source: Venture Impact, 2007

Venture Backed Firms Have Driven Revenue and Employment Growth Even During Economic Slowdowns

Economic Slowdown: Employment and Revenue growth, CAGR 2000-2003



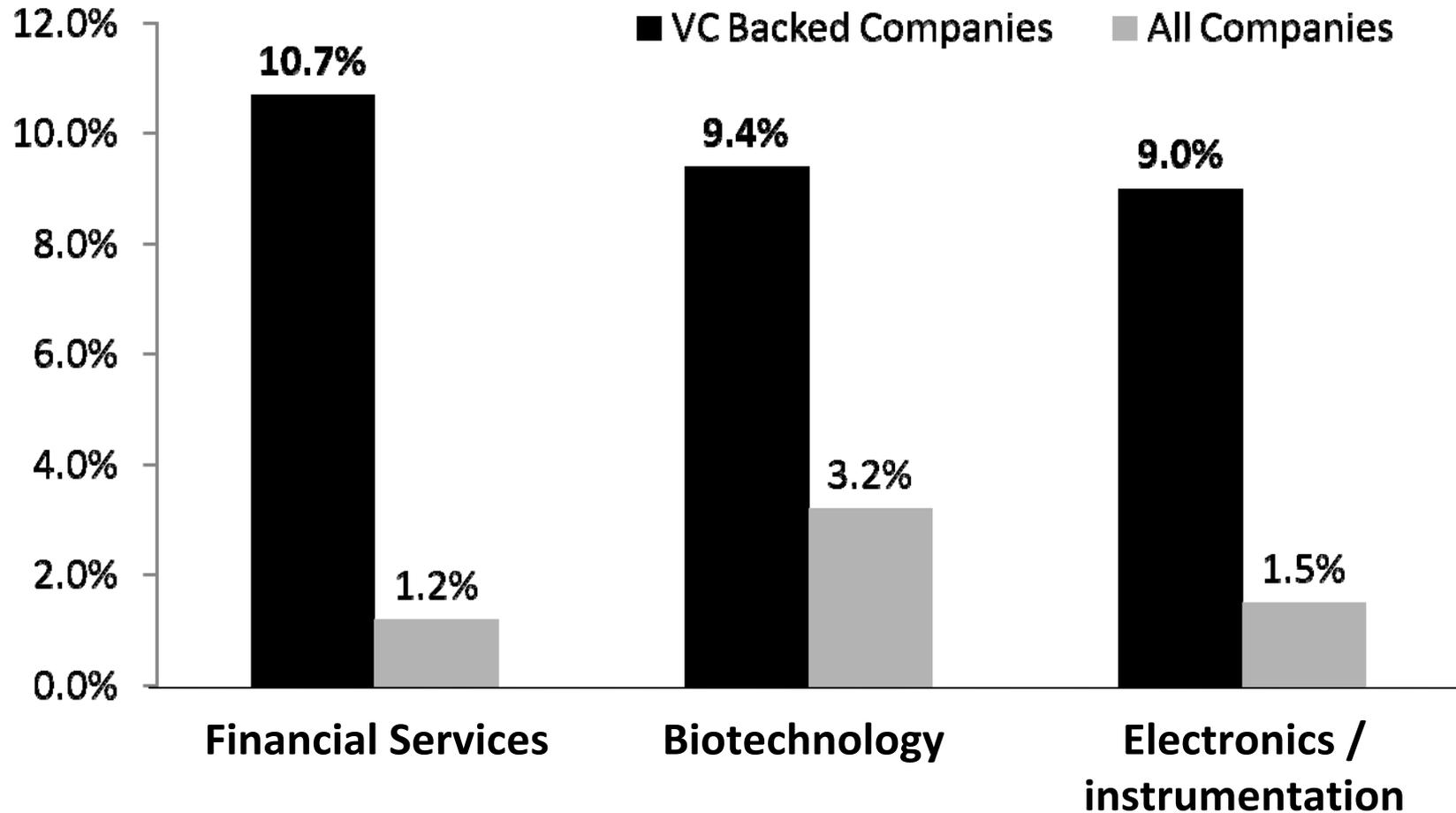
Note: 2000-2003 GDP growth (nominal) was 11.7% (i.e., 3.7% CAGR)
Source: Venture Impact, 2007

Venture Capital is Not Just About Information Technology

| VC backed companies, 2005 | Employment millions | Sales billions |
|--|--------------------------------|---------------------------|
| Media / Entertainment / Retail | 2.0 | 299 |
| Computers and Peripherals | 1.9 | 466 |
| Industrial / Energy | 1.2 | 268 |
| Financial Services | 0.9 | 134 |
| Software | 0.9 | 211 |
| Biotech / Medical Devices / Equipment | 0.5 | NA |

VC Job Creation Relative To Non-Venture Counterparts is Even More Pronounced in Specific Industries

Employment Growth in Leading Industry Sectors, CAGR 2003-2005



Many of Today's Most Innovative Business Models Came From Venture Backed Companies



How Can Countries Create a More Favorable Environment for Venture Capital

- **Provide tax incentives**

- Encourage long term holding
- Keep it simple
- Unsuccessful attempts to learn from: Australia, South Africa

- **Educate investors, particularly foreign investors**

- India example

- **Create critical mass**

- Investment in university based research (e.g., on campus incubation)
- Immigration laws
- “Ok to fail” mindset
- “VC zones” with supporting systems (e.g., Silicon Valley, Research Triangle Park)

Venture Capital in Recession

- **Current recessionary market is very difficult for the Venture Capital market**
 - Raising funds
 - Adjusting spending
 - Managing cash flows
- **Opportunity to make sweeping changes**
 - Sentiment is welcome to change
 - Set forth policies that support venture capital
- **Lay the bricks to build tomorrow's VC Industry**
 - Act today, reap benefits for years to come
 - Create the Googles and Microsofts of tomorrow

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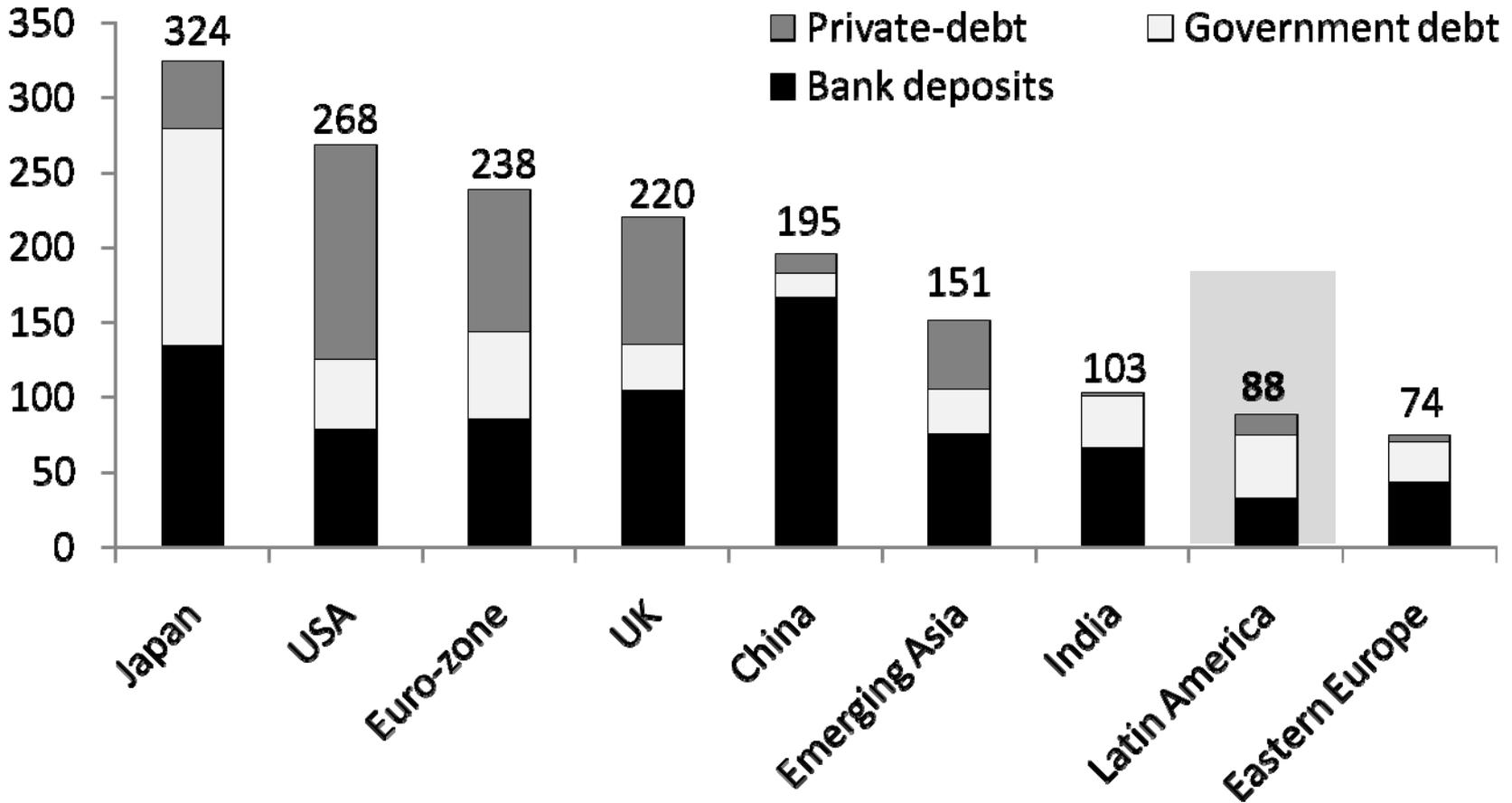
- Venture Capital
- **Fixed Income Markets**
- Role of Diaspora

“Shallow” Fixed Income Markets ...

PRELIMINARY
DATA
FOR DISCUSSION

Depth of Fixed Income Assets, Measured as % of GDP, 2005

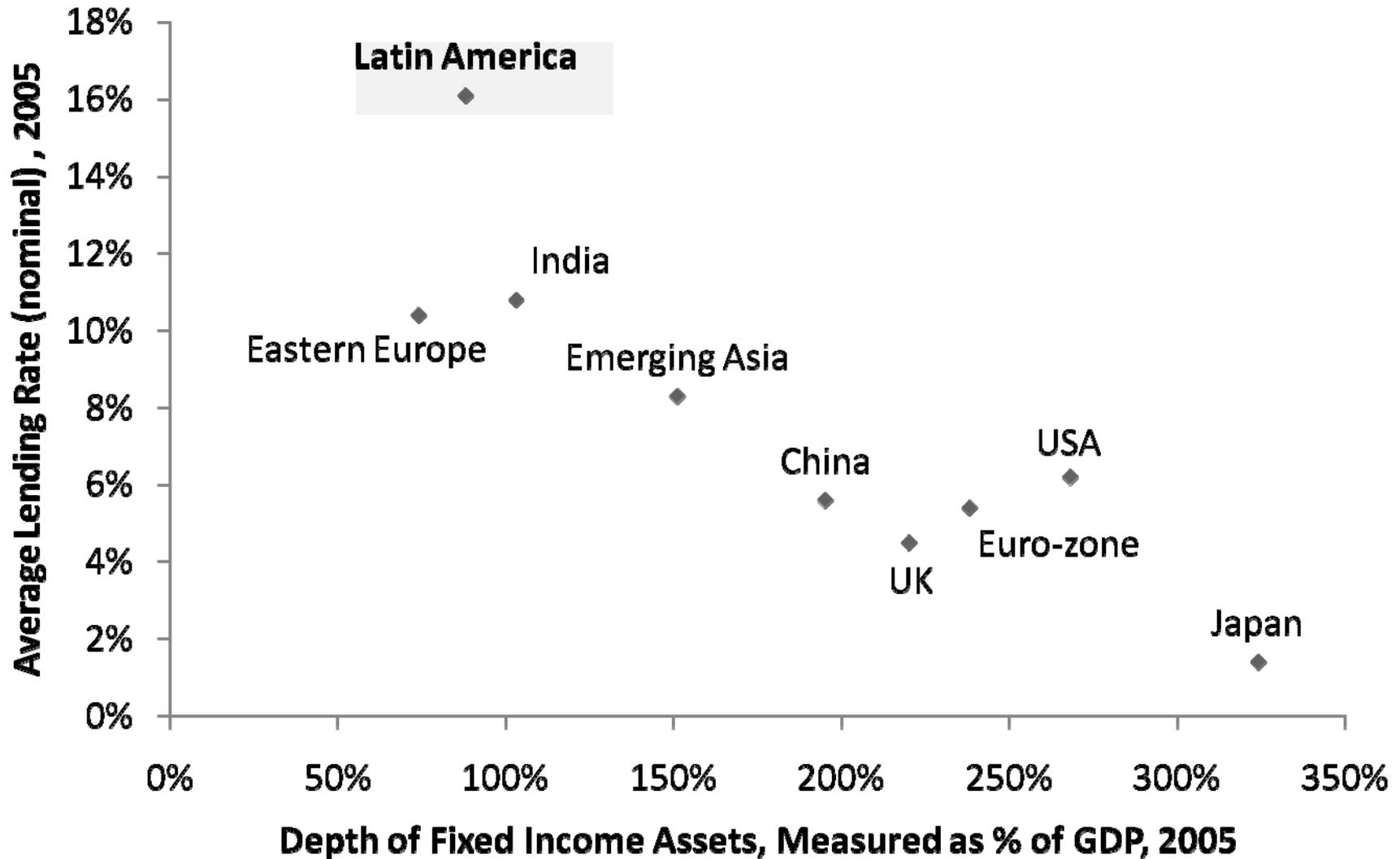
Includes government and private debt securities, and bank deposits



Notes:

1. Eastern Europe: Croatia, Czech Rep., Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russia, Slovenia, Turkey, Ukraine
2. Latin America: Argentina, Bolivia, Brazil, Chile, Columbia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, México, Panamá, Perú, Uruguay, and Venezuela
3. Emerging Asia: Indonesia, Malaysia, Philippines, S. Korea, Thailand

... Can Limit Efficient Access to Capital



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Source: The Economist Intelligence Unit, McKinsey Global Institute

Access to Debt Capital is Difficult for Emerging Markets Borrowers

United States

- Thousands of issuers
- Raise capital locally
- Durations lasting from weeks (commercial paper) to 30+ years and market interest rates
- Infrastructure for sustainable and reliable access to capital
- Even in a long downturn, firms' capital base is strong

India

- Few issuers
- Raised capital in US, UK, and EU
- Primarily short durations (<2 years) at high interest rates
- No local access to capital
- Firms must return to the capital markets regularly

Indian companies face enormous challenges in raising sustainable debt capital.

Implication: Companies in Shallow Markets Struggle to Finance Growth Investments

Latin America Example (2005 data)

Shallow fixed income markets

- **Bank deposits** are 32% of GDP (vs. 75% in emerging Asia, 166% in China)
- **Corporate bond markets** average only 14% of GDP. Chile is the deepest at 21% of GDP, which is less than half the depth of South Korea or Malaysia
- **Low savings rate**, 8.8% of disposable income (vs. 10.4% in Philippines, 25.6% in India, 32.1% in China)
- **High government debt**, 42% of GDP (vs. 30% in emerging Asia, 27% in Eastern Europe)

Difficult to finance investments

- **Large companies: Raise funding from international markets (e.g., USA)**
 - International debt issues nearly 2x the rate of Asian counterparts
- **Small/medium companies: Rely on supplier credit and retained earnings**
 - *McKinsey survey of Latin American executives:*
 - 43% rely on credit from suppliers (vs. 27% of overall respondents)
 - 83% say that more than half of funds for investments come from retained earnings (vs. 66% of overall respondents)

Key Issue for Developing Economies: Unsatisfied Demand for Long Term Capital

- **Demand for capital easily outstrips supply**
- Additional capital will likely need to come from **non-domestic sources**
- To attract and channelize long term capital an economy needs **instruments and institutions of enduring credit quality**
- However developing economies **do not have top, longer dated, credit names**

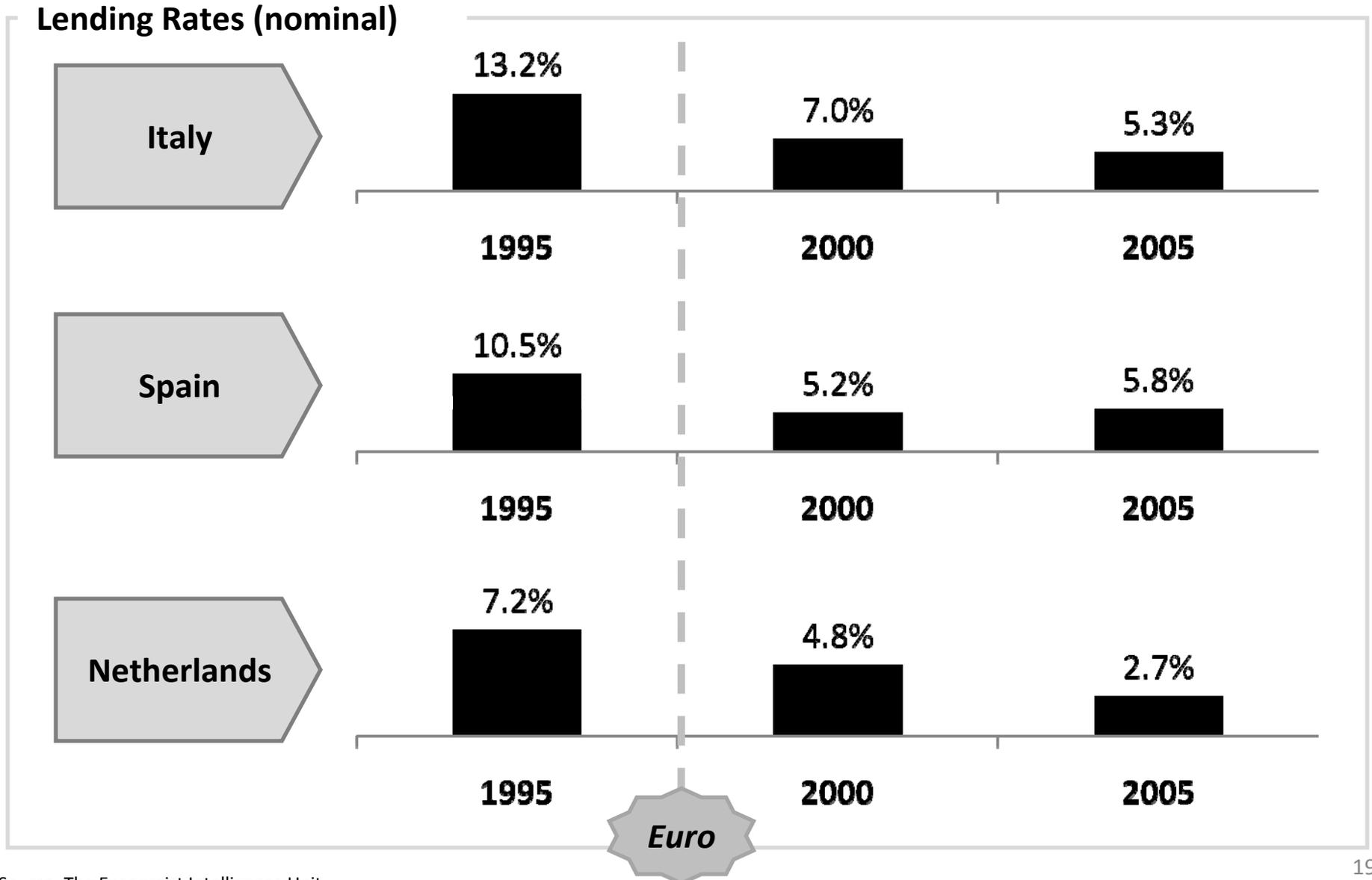
Supra-national Debt Issuances May Help Strengthen Fixed Income Markets in Developing Nations

- **Individual countries lack scale** to develop deep domestic fixed income markets
- **High cost** of borrowing from having to **raise debt in established international debt markets** (e.g., USA, UK)
 - Information asymmetry
 - “Small fish in large pond”

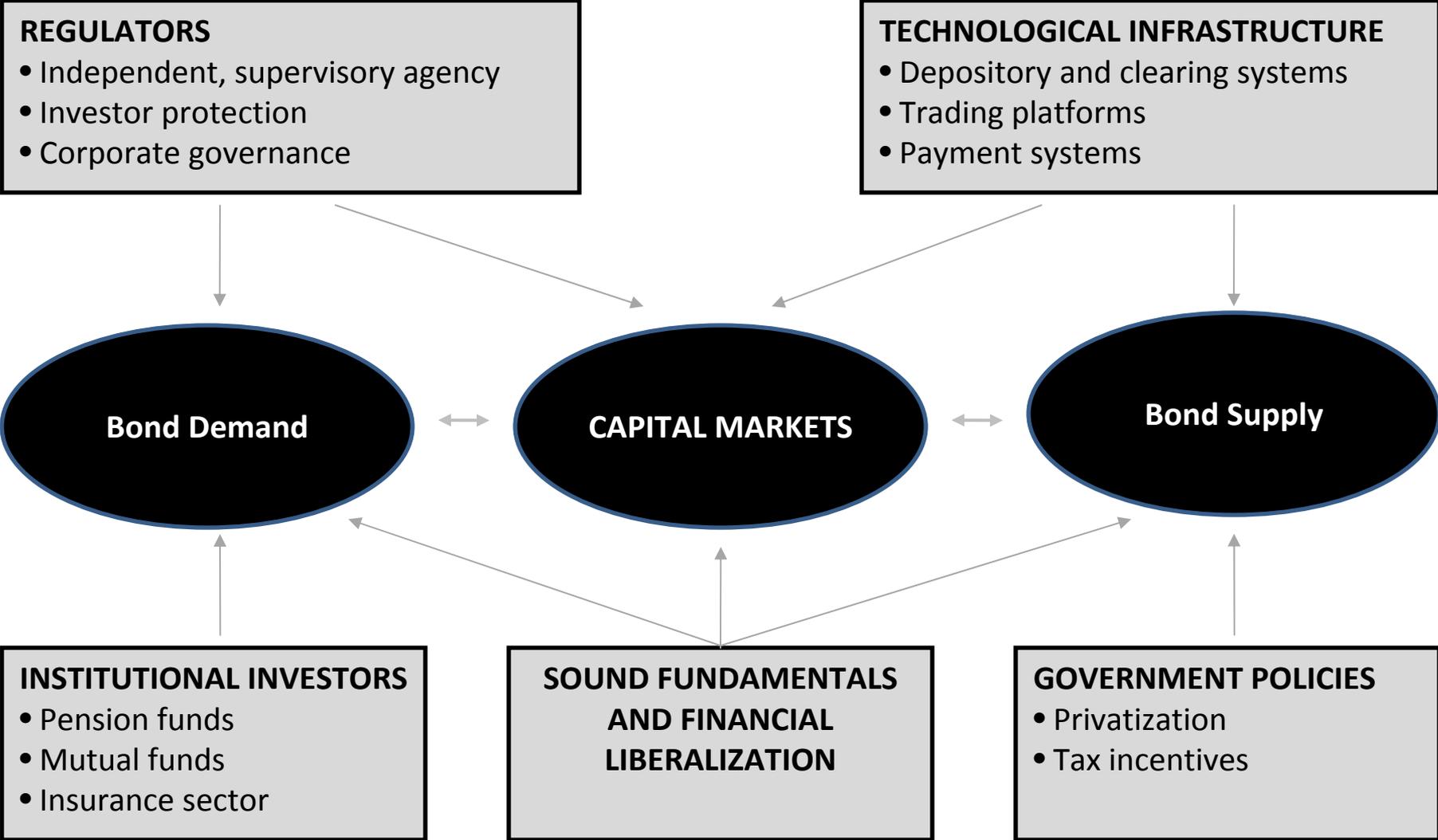
Consider regional, supra-national debt markets (e.g., Latin American fixed income “pool”)

“Supra-national Debt” Illustration: European Union

PRELIMINARY
DATA
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Several Interrelated Levers to Consider in Strengthening Markets for Long Term Capital



Pre-requisites for a Conducive Long Term Capital Environment

India Example

- A sound financial system and institutions that facilitate a proper functioning of the market
- Computer and telecommunication linkages
- Long and short term markets in financial and commodity futures
- Legal structure
- Experienced and qualified people
- Stability and continuity in economic policies
- Globalization of financial markets
- A high savings rate
- Free capital movements

Need to Strengthen Legal Protection for Creditors and Expedite Bankruptcy Proceedings

Latin America Example

- **Enforcing a debt contract** in Latin America takes an average of 587 days and costs more than 20% of the debt's value
 - Compared with 230 days and 5.5% in South Korea
- 39% of Latin American business leaders view **ineffective bankruptcy laws or inefficient courts** as a barrier to the development of financial systems

Suggested Policy Infrastructure Changes to Encourage Long Term Capital

- Withholding taxes – remove them
- Foreign investment limits in Fixed Income instruments – remove them
- Expand the list of investment alternatives to residents
- Capital account convertibility
- Accounting and taxation of derivatives - simplify
- Securitization law and taxation
- Monoline insurers
- Legal/Judiciary reforms to promote speed

Case Studies: Long Term Capital

Case I

■ **US Asset/Mortgage Backed Securities market (mature case):**

- The evolution of US ABS/MBS market is an outstanding example of market innovation, Government policy support through explicit guarantees as well as fiscal relief

Case II

■ **Mexican Pension Fund Reforms (evolving case)**

- In less than 3 years time, the Mexican Pension Fund Reforms has made available domestic investible funds of the order of USD 50 million for investment
- High-quality credit instruments can tap into this capital

Fixed Income in a Recession

- Businesses to need capital to grow
- Local banks have slowed lending
- Foreign debt markets offer sub-optimal terms
 - Short duration (<2 years)
 - High costs to borrow
 - Lenders are detached from local businesses
- Establishing local debt markets could be a solution
 - Longer duration (10+ years)
 - Reasonable interest rates
 - Opportunity to tap local lenders directly

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- **Role of Diaspora**

Diaspora Can Have a Significant Impact

Nature of contributions

■ Remittances and investment

- In 1999, 70% of China FDI came from Chinese people living abroad
- Silicon Valley Indians “seeding” startups in Bangalore & Hyderabad

■ Knowledge and intellectual capital

- Advise to government (e.g., policy to encourage venture capital, deregulation of industries)
- Financing of elite educational institutions
- Business internships and exchange programs

Leveraging the diaspora

■ Create emigrant networks

- Professional
- Economic
- Educational
- Social

■ Facilitate information flow

- Communication infrastructure
- E.g., database of expats, information on investment opportunities

■ Provide incentives

- Financial: E.g. Foreign currency deposits, removing restrictions on profit repatriation
- Other: High profile awards

Leveraging Diaspora for Entrepreneurship: TiE Example



The Indus Entrepreneurs (TiE): world's largest not-for-profit organization for entrepreneurs

- **Founded in 1992** in Silicon Valley by a group of successful entrepreneurs, corporate executives, and senior professionals with roots in the Indus region
- Currently **12,000 members in 45 chapters across 10 countries**
- **Mission: foster entrepreneurship globally** through mentoring, networking, and education
- **Achievements:**
 - Largest pool of intellectual capital anywhere
 - Brand globally synonymous with entrepreneurship
 - Annual conference, TiECon, regarded largest entrepreneurial forum in the world
 - Helped boost the economies of the communities in which it operates
 - Economic wealth creation estimated at \$200 billion
 - Significant involvement in social entrepreneurship
 - Influenced liberalization of key economic sectors in India and Pakistan

Final Thoughts

- **Venture Capital is a local business**
 - Critical mass is easier to get to
 - It is not technology
- **Fixed Income needs size**
 - Encourage securitization
 - Join up with your neighbors
- **Leverage Diaspora**
 - Build networks
 - Facilitate information flow
 - Provide incentives